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As filed with the Securities and Exchange Commission on January 22, 2007.

Registration No. 333-

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM S-1****REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933****NEUTRAL TANDEM, INC.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**(State or Other Jurisdiction of  
Incorporation or Organization)**4813**(Primary Standard Industrial  
Classification Code Number)**31-1786871**(I.R.S. Employer  
Identification Number)**One South Wacker Drive  
Suite 200****Chicago, Illinois 60606  
(312) 384-8000**(Address, Including Zip Code, and Telephone Number, Including Area Code, of  
Registrant's Principal Executive Offices)**OFFICIAL FILE  
ICC****Rian J. Wren  
President and Chief Executive Officer  
Neutral Tandem, Inc.  
One South Wacker Drive  
Suite 200****Chicago, IL 60606  
(312) 384-8000**(Name, Address, Including Zip Code, and Telephone Number, Including Area Code,  
of Agent For Service)**EVIDENCE****07-0277****MAY 22, 2007***Level 3 ex 14***With copies to:****Gerald T. Nowak  
Andrew J. Terry  
Kirkland & Ellis LLP  
200 E. Randolph Drive  
Chicago, Illinois 60601  
(312) 861-2000****Richard A. Drucker  
Davis Polk & Wardwell  
450 Lexington Avenue  
New York, New York 10017  
(212) 450-4000****Approximate date of commencement of proposed sale to the public:**  
As soon as practicable after this registration statement becomes effective.If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box: ☐If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. ☐**CALCULATION OF REGISTRATION FEE**

Title of Each Class of Securities to be Registered	Proposed Maximum Aggregate Offering Price <sup>(1)</sup> (2)	Amount of Registration Fee
Common Stock, \$0.01 par value	\$ 75,000,000	\$ 8,025

- (1) Includes shares of common stock that the underwriters have the option to purchase from Neutral Tandem to cover over-allotments, if any.
- (2) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(o) under the Securities Act of 1933.

The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, or until this Registration Statement shall become effective on such date as the Securities and Exchange Commission acting pursuant to said Section 8(a) may determine.

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. The prospectus is not an offer to sell these securities nor a solicitation of an offer to buy these securities in any jurisdiction where the offer and sale is not permitted.

**PRELIMINARY PROSPECTUS (Subject to Completion)**  
**ISSUED JANUARY 22, 2007**



This is Neutral Tandem, Inc.'s initial public offering of shares of common stock and no public market exists for our shares. Neutral Tandem is offering \_\_\_\_\_ shares of common stock, and the selling shareholders named in this prospectus are offering \_\_\_\_\_ shares of our common stock. We will not receive any proceeds from the sale of our common stock by the selling shareholders.

We anticipate that the initial public offering price will be between \$ \_\_\_\_\_ and \$ \_\_\_\_\_ per share. We intend to apply to list our common stock on the NASDAQ Global Market under the symbol "TNDM."

Investing in our common stock involves risks. See "Risk Factors" beginning on page 8.

PRICE \$ \_\_\_\_\_ A SHARE

	<u>Price to Public</u>	<u>Underwriting Discounts and Commissions</u>	<u>Proceeds to Neutral Tandem</u>	<u>Proceeds to Selling Shareholders</u>
Per share	\$ _____	\$ _____	\$ _____	\$ _____
Total	\$ _____	\$ _____	\$ _____	\$ _____

The underwriters may also purchase up to an additional \_\_\_\_\_ shares of common stock from the selling shareholders, at the public offering price, less the underwriting discount, within 30 days from the date of this prospectus to cover any over-allotments.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares of common stock to purchasers on \_\_\_\_\_, 2007.

Sole Book Runner

**MORGAN STANLEY**

**CIBC WORLD MARKETS**

\_\_\_\_\_, 2007

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You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized anyone to provide you with information different from that contained in this prospectus. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our common stock. Our business, financial condition, results of operations and prospectus may have changed since that date. In this prospectus, "Neutral Tandem," "the Company," "we," "us" and "our" refer to Neutral Tandem, Inc. and its subsidiaries.

In this prospectus we sometimes refer to various industry and other terms and abbreviations, which we have defined under "Glossary" in this prospectus.

We have not taken any action to permit a public offering of the shares of common stock outside the United States or to permit the possession or distribution of this prospectus outside the United States. Persons outside the United States who come into possession of this prospectus must inform themselves about and observe any restrictions relating to the offering of the shares of common stock and the distribution of this prospectus outside of the United States.

Until , 2007, 25 days after the commencement of this offering, all dealers that buy, sell, or trade shares of our common stock, whether or not participating in this offering, may be required to deliver a prospectus. This delivery requirement is in addition to the dealers' obligations to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

**MARKET AND INDUSTRY DATA AND FORECASTS**

Market data and certain industry data and forecasts used throughout this prospectus were obtained from internal company surveys, market research, consultant surveys, publicly available information, reports of governmental agencies and industry publications and surveys. Industry surveys, publications, consultant surveys and forecasts generally state that the information contained therein has been obtained from sources believed to be reliable, but that the accuracy and completeness of such information is not guaranteed. We have not independently verified any of the data from third-party sources, nor have we ascertained the underlying economic assumptions relied upon therein. Similarly, internal surveys, industry forecasts and market research, which we believe to be reliable based upon our management's knowledge of the industry, have not been independently verified. While we are not aware of any material misstatements regarding our industry data presented herein, our estimates involve risks and uncertainties and are subject to change based on various factors, including those discussed under the heading "Risk Factors" in this prospectus.

Table of Contents**PROSPECTUS SUMMARY**

*This summary highlights selected information contained elsewhere in this prospectus. This summary may not contain all the information that you should consider before investing in our common stock. You should carefully read the entire prospectus, including "Risk Factors" and our consolidated financial statements and related notes included elsewhere in this prospectus, before making an investment decision.*

**Our Company**

We are a leading provider of tandem interconnection services to competitive carriers, including wireless, wireline, cable telephony and Voice over Internet Protocol, or VoIP, companies. Competitive carriers use tandem switches to interconnect and exchange traffic between their networks without the need to establish direct switch-to-switch connections. Prior to the introduction of our service, the principal method for competitive carriers to exchange traffic was through the use of the incumbent local exchange carriers', or ILECs, tandem switches. Under interpretations of the Telecommunications Act of 1996, ILECs are required to provide tandem switching to competitive carriers pursuant to prescribed rates established by regulatory authorities. Our solution enables competitive carriers to exchange traffic between their networks without using an ILEC tandem.

The proliferation of competitive carriers over the past decade and their capture of an increasing share of subscribers has shifted a greater amount of intercarrier traffic to ILEC tandem switches and amplified the complexity of carrier interconnections. This has resulted in additional traffic loading of ILEC tandems, lower service quality and substantial costs incurred by competitive carriers for interconnection. A loss of ILEC market share to competitive carriers has escalated competitive tensions and resulted in an increased demand for tandem switching.

We founded our company to solve these interconnection problems and better facilitate the exchange of traffic among competitive carriers. By utilizing our managed tandem solution, our customers benefit from a simplified interconnection network solution which reduces costs, increases network reliability, decreases competitive tension and adds network diversity and redundancy. Since the launch of our service in 2004, we believe we have established the largest network of tandem switches serving as neutral interconnection points for voice traffic between competitive carriers in the United States.

We have 56 signed agreements with major competitive carriers and operate in 33 markets. Currently, we provide service to leading competitive carriers in the United States, including wireless carriers such as Sprint Nextel Corp., T-Mobile USA, Inc., MetroPCS Wireless Inc., U.S. Cellular Corporation and Cingular Wireless LLC; cable companies such as Cablevision Systems Corporation, Comcast Cable Communications, Inc., RCN Corporation and Cox Communications Inc.; wireline carriers such as AT&T Inc., McLeod USA Inc., MCI/Verizon Business, Level 3 Communications Inc. and XO Communications Inc.; and VoIP providers such as Vonage Holdings Corp., Broadvox Carrier Services, LLC, Voex Inc. and Reynwood Communications Inc. Our network currently carries approximately 2.5 billion minutes of traffic per month and is capable of terminating calls to over 151 million assigned telephone numbers. As the telecommunications market share continues to shift from traditional ILEC access lines to competitive carriers, we believe we will have access to an expanding market. We believe that our neutral tandem network and its size and scale will provide us with opportunities to enter new markets, increase market share with current customers and attract new customers.

Since commencing service in February 2004, we have grown rapidly, generating revenue of approximately \$28.0 million in fiscal 2005. During the nine months ended September 30, 2006, we increased revenue to \$37.9 million, an increase of 108% compared to the nine months ended September 30, 2005, and net income was approximately \$6.2 million.

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### Our Industry

In recent years, a wide array of new services and technologies has emerged as competitive alternatives to ILEC services for consumer and enterprise telephony. The increasingly diverse market now includes wireless, cable telephony, wireline and VoIP companies. As these competitive carriers have expanded their customer bases, the amount of traffic exchanged between them has also increased and is expected to grow in the future.

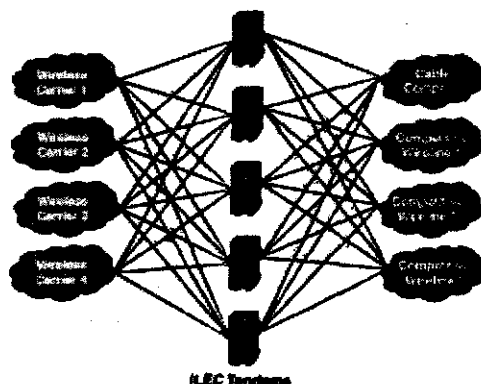
According to the Local Exchange Routing Guide, or LERG, an industry standard guide used by carriers, there are approximately 1.4 billion telephone numbers assigned to carriers in North America. Our services are principally targeted to address the estimated 722 million, or 52% of the total 1.4 billion, telephone numbers assigned to competitive carriers.

Prior to the introduction of our services, competitive carriers had two alternatives for exchanging traffic between their networks. The two alternatives were interconnecting to the ILEC tandems or directly connecting individual switches, commonly referred to as "direct connects." Given the cost and complexity of establishing direct connects, competitive carriers resorted to utilizing the ILEC tandem as the primary method of exchanging traffic. The ILECs often required competitive carriers to interconnect to multiple ILEC tandems with each tandem serving a restricted geographic area. In addition, as the competitive telecommunications market grew, the process of establishing interconnections at multiple ILEC tandems became increasingly difficult to manage and maintain, causing delays and inhibiting competitive carrier growth and the purchase of ILEC tandem services became an increasingly significant component of a competitive carrier's costs.

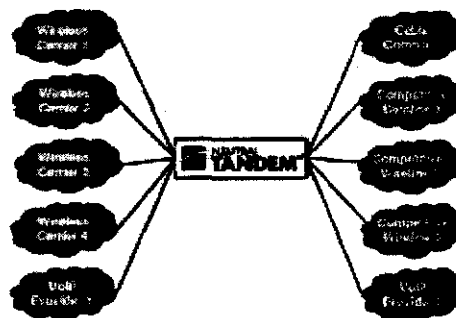
Growth in intercarrier traffic switched through ILEC tandems has created switch capacity shortages known in the industry as ILEC "tandem exhaust," where overloaded ILEC tandems become a bottleneck for competitive carriers. This has increased call blocking and given rise to service quality issues for competitive carriers. With the introduction of our services, we believe we became the first carrier to provide alternative tandem services capable of alleviating the ILEC tandem exhaust problem.

The following diagrams illustrate interconnecting via the ILEC tandem networks and an example of interconnecting via our managed tandem network.

Interconnecting via the ILEC Tandem Network within a Market



Interconnecting via Neutral Tandem Network within a Market



The second alternative for exchanging traffic, prior to us, was directly connecting competitive carrier switches to each other. Implementing direct switch-to-switch network connections between all competitive switches in a market is very challenging. For example, in order to completely bypass the ILEC tandem network, a market with 100 competitive switches would require 9,900 direct one-way switch-to-switch connections. The capital and operating expense requirements, complexity and management challenges of establishing and maintaining direct connections generally makes them uneconomical for all but the highest traffic switch combinations and an impractical network-wide solution.

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### **Our Services**

Our services allow competitive carriers to exchange traffic between their networks without using an ILEC tandem or establishing direct connections. Each competitive carrier that connects to our network generally gains access to all other competitive carriers' switches connected to our network.

Once connected to our network, carriers can route their traffic to other destinations (telephone numbers) that are addressable by our network. We charge on a per-minute basis for traffic switched by our network. We have an established system for monitoring and tracking customer traffic volumes, and have historically been able to predict these volumes with relative accuracy. Our customers typically use our services for all, or the majority of, their tandem switching needs if our network connects to the desired final destination. In addition, our customers provide us with forecasts of future traffic levels. Together, this system of predicting traffic volumes for both existing and new customers allows us to reasonably estimate future revenue streams.

As a core component of our service offering, we actively manage network capacity between our tandem switches and customers' switches, which results in improved network quality and reduced call blocking. By constantly monitoring traffic levels and projecting anticipated growth in traffic, we are generally able to provide on a timely basis additional circuits between customer switches and our network to meet increased demand.

Our managed tandem network includes technologically advanced Internet Protocol, or IP, and Time Division Multiplexing, or TDM, switching platforms linked together by an IP backbone. Our network is capable of automatically switching IP-originated or conventional TDM traffic to terminating carriers using either protocol. We support IP-to-IP, IP-to-TDM, TDM-to-IP and TDM-to-TDM traffic with appropriate protocol conversion and gateway functionality.

Our network currently connects 580 unique competitive carrier switches, creating up to 335,820 unique switch-to-switch routes serving 151 million telephone numbers assigned to these carriers. In the quarter ended September 30, 2006, our network carried approximately 2.5 billion minutes of traffic per month.

### **Our Strengths**

We believe the following strengths differentiate us and position us for continued growth.

- **Market Leading Position.** We believe we have built the largest neutral tandem network in the United States. By being "first-to-market" in the metropolitan areas we serve, we have built significant scale for carrier interconnections and access to terminating telephone numbers.
- **Strong "Network Effect."** The value of our service offering increases with the number of carriers connected to our network. The addition of each new customer to our network allows the new customer to route traffic to all of our existing customers and allows all of our existing customers to route traffic to the new customer. The "network effect" of adding an additional customer to our platform creates a significant opportunity for existing customers to realize incremental savings by increasing the volume of traffic switched by our tandem network.
- **Network-Neutral Position.** Unlike the ILECs, we are positioned as a neutral, third party tandem service provider and generally do not directly compete with our customers. Therefore, we do not have the competitive tensions and conflicts of interest of an ILEC in providing tandem interconnection services.
- **Large and Growing Market.** The continuing shift of telecommunications traffic away from conventional ILEC phone lines to the wireless, VoIP, cable telephony and other wireline segments, provides opportunities for us to continue to expand our business. Our tandem network was designed to serve the interconnection needs of these rapidly growing segments of the communications market, and since the initiation of our service in 2004, we feel we have built strong relationships with a

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majority of the leading carriers in these segments, which we believe provides opportunities for us to grow with our customers.

- **Adaptable Technology and Proprietary Software Tools.** Our switching architecture utilizes platforms manufactured by Sonus Networks, Inc. and Nortel Networks Corp. We have deployed a full suite of Sonus Networks' IMS (IP Multimedia Subsystem)-ready solutions which enables us to interconnect to customers on either a TDM or IP interface. In addition, we support both conventional Signaling System 7, or SS7, and Session Initiation Protocol, or SIP, call routing.

We believe the adaptability and flexibility of our technology enables us to provide more robust service offerings to interconnect a wider range of traffic types and to adapt our service offerings more efficiently than the ILECs, which predominantly employ legacy Class 4 TDM-only circuit switching technology for tandem switching.

- **Experienced Management Team.** We have an experienced management team committed to expanding our position as a leading provider of neutral tandem services.

**Our Strategy**

Our strategy is focused on expanding our business by increasing the share of telecommunications traffic that our tandem network can serve. Expanding our share of telecommunications traffic increases the value of our network to our customers and enables us to capture a larger share of total telecommunications revenue. Key elements of our expansion strategy include:

- **Broaden our geographic presence.** Our managed tandem services are currently available in 33 markets, serving 151 million assigned telephone numbers out of a potential addressable market of 322 million telephone numbers assigned to competitive carriers in these 33 markets. We plan to broaden our geographic presence in 2007 to include an additional 18 markets. After completing the planned expansion, we estimate that, based upon information published in the LERG, our potential addressable market opportunity will include over 400 million telephone numbers assigned to competitive carriers in those markets. Many of our existing customers provide service in one or more of these new markets. We intend to market our services to our customers in these new markets.
- **Expand our customer base.** As our network expands, our market opportunity will include additional competitive carriers (particularly regional wireless carriers and cable companies) that are not in the markets we currently serve. Many of these potential customers are among the fastest growing carriers in their service areas.
- **Grow customer traffic.** Three factors principally drive traffic growth from customers: routing opportunities to new customers, routing opportunities in new markets and growth in our customers' traffic volumes. As we add new customers to our network, we receive incremental revenue from the new customer and from all existing customers terminating traffic to the new customer. This "network effect," our expansion strategy and focus on serving the fastest growing segments of the competitive telephony industry positions us well to grow customer traffic.
- **Increase the types of traffic we exchange.** Our business originally connected only local traffic among carriers within a single metropolitan market. In 2006, we installed a national IP backbone network connecting our major local markets. As a result, our service offerings now include the capability of switching and carrying traffic between multiple markets.

**Company Information**

We were incorporated in Delaware on April 19, 2001. We commenced operations in November 2003 and began generating revenue with the launch of our service in February 2004. Our principal executive offices are located at One South Wacker Drive, Suite 200, Chicago, Illinois 60606. Our telephone number is (312) 384-8000. Our Web site address is <http://www.neutraltandem.com>. The information contained on our Web site is not to be considered a part of this prospectus.



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## Common stock offered:

By Neutral Tandem, Inc.  
By the selling shareholders  
Total

shares  
shares  
shares

## Common stock to be outstanding immediately after this offering

shares

## Use of proceeds

We estimate that we will receive net proceeds from our sale of shares of common stock in this offering of \$ , assuming an initial public offering price of \$ per share (the mid-point of the range set forth on the cover of this prospectus), after deducting underwriting discounts and commissions and estimated offering expenses payable by us. We intend to use the net proceeds to fund the continued expansion of our business. Pending such use, the net proceeds will be used for working capital, capital expenditures and general corporate purposes. We currently cannot estimate the portion of the net proceeds which will be used for any specific purpose.

We will not receive any of the proceeds from the sale of shares by the selling shareholders. See "Use of Proceeds."

## Risk Factors

See "Risk Factors" and the other information included in this prospectus for a discussion of factors you should carefully consider before deciding to invest in shares of our common stock.

## Proposed NASDAQ symbol

"TNDM"

Unless the context requires otherwise, the number of shares of our common stock to be outstanding after this offering is based on the number of shares outstanding as of December 31, 2006. The number of shares of our common stock to be outstanding after this offering gives effect to this issuance prior to completion of this offering of shares of common stock upon the exercise of outstanding warrants by certain selling shareholders but does not take into account:

- shares of common stock issuable upon the exercise of outstanding stock options as of December 31, 2006 at a weighted average exercise price of \$ per share;
- an aggregate of shares of common stock that will be reserved for future issuances under our 2007 Long-Term Incentive Plan as of the closing of this offering; and
- shares of our common stock issuable upon the exercise of outstanding warrants as of December 31, 2006 which shall be exercisable for an aggregate of shares of common stock upon completion of the offering with a weighted average exercise price of \$ per share.

Unless otherwise noted, the information in this prospectus assumes that the underwriters do not exercise their over-allotment option granted by the selling shareholders, and has been adjusted to reflect the -for- reverse stock split of our common stock that was effected prior to the completion of this offering, the automatic conversion of our outstanding shares of Series A preferred stock, Series B-1 preferred stock, Series B-2 preferred stock and Series C preferred stock into an aggregate of shares of common stock upon the completion of this offering, the filing of our amended and restated certificate of incorporation and the adoption of our amended and restated by-laws upon the completion of this offering.

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The following tables summarize our historical consolidated financial information and other data for the periods presented. The consolidated financial information presented as of and for the fiscal years ended December 31, 2004 and December 31, 2005, was derived from our consolidated financial statements, which have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, and are included elsewhere in this prospectus. The consolidated financial information presented as of and for the nine months ended September 30, 2005 and September 30, 2006, was derived from our unaudited consolidated financial statements, and are included elsewhere in this prospectus. The pro forma as adjusted balance sheet data as of September 30, 2006 give effect to this offering of common stock at a price of \$ per share (the mid-point of the range set forth on the cover of this prospectus), the conversion of all of our preferred stock into an aggregate of shares of common stock upon the closing of this offering and the application of the net proceeds therefrom as described under "Use of Proceeds." The unaudited consolidated financial statements include all adjustments, consisting of normal recurring adjustments, which we consider necessary for a fair presentation of the financial position and the results of operations for these periods. Operating results for the nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the entire year ending December 31, 2006. This data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our audited and unaudited consolidated financial statements and related notes included elsewhere in this prospectus.

	Year Ended December 31,		Nine Months Ended September 30,	
	2004	2005	2005	2006
	(In thousands, except share data)			
<b>Statements of Operations</b>				
Revenue	\$ 3,439	\$27,962	\$18,177	\$37,864
Operating Expense:				
Costs of revenue (excluding depreciation and amortization shown separately below)	2,027	11,349	7,467	14,621
Operations	2,704	8,189	5,868	8,150
Depreciation and amortization	655	3,141	2,011	4,464
Sales and marketing	775	1,360	991	1,149
General and administrative	2,310	3,053	2,361	2,785
Total operating expense	8,471	27,092	18,698	31,169
Income (Loss) From Operations	(5,032)	870	(521)	6,695
Other (Income) Expense:				
Interest expense	276	843	594	849
Interest income	(69)	(170)	(140)	(556)
Other income	—	(11)	—	—
Total other expense	207	662	454	293
Income (Loss) Before Income Taxes	(5,239)	208	(975)	6,402
Provision (Benefit) For Income Taxes	—	—	—	157
Net Income (Loss)	<u>\$(5,239)</u>	<u>\$ 208</u>	<u>\$ (975)</u>	<u>\$ 6,245</u>
Earnings (loss) per common share—basic <sup>(1)</sup>	\$ (1.02)	\$ 0.04	\$ (0.17)	\$ 1.18
Earnings (loss) per common share—diluted <sup>(1)</sup>	\$ (1.02)	\$ 0.01	\$ (0.17)	\$ 0.26
Weighted average common shares—outstanding-basic	5,117	5,628	5,632	5,300
Weighted average common shares—outstanding-diluted	5,117	21,403	5,632	23,979

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Capital expenditures

EBITDA<sup>(2)</sup>

Minutes of Use Billed (in millions)

Year Ended December 31,		Nine Months Ended September 30,	
2004	2005	2005	2006
(Dollars in thousands)			
\$ 8,144	\$13,977	\$12,466	\$10,744
\$(4,377)	\$ 4,022	\$ 1,490	\$11,159
1,022	10,428	6,427	17,388

As of September 30, 2006

Actual	Pro Forma As Adjusted
(In thousands)	

**Balance Sheet Data:**

Cash and cash equivalents

Total current assets

Total assets

Total current liabilities

Total liabilities

Total preferred stock

Total shareholders' equity

\$20,903	\$
30,640	
62,234	
15,951	
23,302	
38,000	
932	

- (1) Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed giving effect to all dilutive potential common shares that were outstanding during the period. The effect of stock options and warrants represents the only difference between the weighted average shares used for the basic earnings (loss) per share computation compared to the diluted earnings (loss) per share computation.
- (2) EBITDA is defined as net income before (i) depreciation and amortization, (ii) interest income and expense and (iii) income taxes. Management believes that the presentation of EBITDA included in this prospectus provides useful information to investors regarding our results of operations because it assists in analyzing and benchmarking the performance and value of our business. Although we use EBITDA as a financial measure to assess the performance of our business, the use of EBITDA is limited because it does not include certain material costs, such as depreciation, amortization and interest, necessary to operate our business. EBITDA included in this prospectus should be considered in addition to and not as a substitute for, net income as calculated in accordance with generally accepted accounting principles as a measure of performance.

The following is a reconciliation of net income (loss) to EBITDA:

	Year Ended December 31,		Nine Months Ended September 30,	
	2004	2005	2005	2006
	(In thousands)			
Net income (loss)	\$(5,239)	\$ 208	\$ (975)	\$ 6,245
Interest expense-net	207	673	454	293
Income tax expense	—	—	—	157
Depreciation and amortization	655	3,141	2,011	4,464
EBITDA	<u>\$(4,377)</u>	<u>\$4,022</u>	<u>\$1,490</u>	<u>\$11,159</u>

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*This offering involves a high degree of risk. You should consider carefully the risks and uncertainties described below and the other information in this prospectus, including the consolidated financial statements and the related notes appearing at the end of this prospectus, before deciding to invest in shares of our common stock. If any of the following risks or uncertainties actually occur, our business, prospects, financial condition and operating results would likely suffer, possibly materially. In that event, the market price of our common stock could decline and you could lose all or part of your investment. Additional risks and uncertainties not currently known to us or those we currently deem to be immaterial may also materially and adversely affect our business, financial condition or results of operations.*

**Risk Factors Related To Our Business**

*Failures or interruptions of our tandem network or the loss of, or damage to, a tandem network switch site could materially harm our revenues and impair our ability to conduct our operations.*

We provide telecommunications services that are critical to the operations of our customers. Notably, our tandem network service is essential to the orderly operation of our customers' telecommunications system because it enables competitive carriers to ensure that telephone calls are routed to the appropriate destinations. Our tandem network architecture is integral to our ability to process a high volume of transactions in a timely and effective manner. We could experience failures or interruptions of our tandem network and services, or other problems in connection with our operations, as a result of:

- damage to, or failure of, our tandem network software or hardware or our connections and outsourced service arrangements with third parties;
- errors in the processing of data by our systems;
- computer viruses or software defects;
- physical or electronic break-ins, sabotage, intentional acts of vandalism, natural disasters and similar events;
- increased capacity demands or changes in systems requirements of our customers; or
- errors by our employees or third-party service providers.

If we cannot adequately protect the ability of our tandem network to perform consistently at a high level or otherwise fail to meet our customers' expectations:

- we may be unable to provide and bill for services;
- we may experience damage to our reputation, which may adversely affect our ability to attract or retain customers for our existing services, and may also make it more difficult for us to market our services;
- we may be subject to significant damages claims, under our contracts or otherwise;
- our operating expenses or capital expenditures may increase as a result of corrective efforts that we must perform;
- our customers may postpone or cancel subsequently scheduled work or reduce their use of our services; or
- one or more of our significant contracts may be terminated early, or may not be renewed.

Any of these consequences would adversely affect our revenues and performance.

We may not have sufficient redundant systems or back up facilities to allow us to receive and process calls in the event of a loss of, or damage to, a tandem network switch site. We could lose, or suffer damage to, a site in the event of power loss, natural disasters such as fires, earthquakes, floods and tornadoes, telecommunications failures, such as transmission cable cuts, or other similar events that could adversely affect our customers' ability to access our tandem network services. Any such loss or damage could interrupt our operations, materially harm our revenues and growth and require significant cash expenditures to correct the failures caused by such loss or damage.

Table of Contents***Regulatory developments could negatively impact our business.***

The communications services industry is highly regulated by the federal government and the individual states. While the pricing of our services is generally not heavily regulated by the Federal Communications Commission, or FCC, and state utility agencies, these agencies have greater regulatory authority over the pricing of incumbent local exchange carriers, or ILECs, transit services, which generally sets the benchmark for the prices of competitive services that we offer. To the extent that the ILEC transit rates are reduced, it could have an adverse impact on us.

For example, in Michigan, in 2005, the Michigan Public Service Commission revised the maximum allowable rate that AT&T Inc., or AT&T, could charge for transit service based on AT&T's total element long run incremental cost, or TELRIC, which was significantly below the rate previously charged by AT&T (previously SBC Communications). This decision had a significant impact on the profitability of our service in Michigan.

The FCC currently does not actively regulate the services we offer. If, however, the FCC determined, on its own motion or in response to a third party's filing, that it should more actively regulate our services, the FCC could limit the rates we charge or require us to change other terms or conditions of our service offerings. For example, in 2001 the FCC initiated a proceeding to address intercarrier compensation issues, such as rules that require one carrier to make payments to another carrier for access to the other's network. As part of that docket, on July 24, 2006, a group of large and rural local exchange carriers, or LECs, filed a proposal for intercarrier compensation reform at the FCC called the Missoula Plan, which includes provisions regarding tandem transit services. Under the Missoula Plan, tandem transit service would be provided at a rate not to exceed \$0.0025 per minute of use for the first four years of the plan, and then increase with inflation. This rate is lower than the rates charged by the ILECs or by us in several of the markets in which we currently operate. The FCC currently is considering public comments on the Missoula Plan. Independent of or in combination with the Missoula Plan, the FCC could make significant changes in the pricing of transit traffic, including lowering the rate, freezing the rate or establishing uniform rates. In addition, from time to time, carriers that we connect with have requested that we pay them to terminate traffic, and this proceeding will likely address those rights or obligations.

As communications technologies and the communications industry continue to evolve, the statutes governing the communications industry or the regulatory policies of the FCC may change. If this were to occur, the demand and pricing for our tandem network services could change in ways that we cannot easily predict and our revenues could decline. These risks include the ability of the federal government, including Congress or the FCC, or state legislatures or agencies, to:

- increase regulatory oversight over the services we provide;
- adopt or modify statutes, regulations, policies, procedures or programs that are disadvantageous to the services we provide, or that are inconsistent with our current or future plans, or that require modification of the terms of our existing contracts, including reducing the rates for tandem services; or
- adopt or modify statutes, regulations, policies, procedures or programs in a way that could cause changes to our operations or costs or the operations of our customers, including the pricing of our services to our customers.

We cannot predict when, or upon what terms and conditions, further regulation or deregulation might occur or the effect future regulation or deregulation may have on our business. Any of these government actions could have a material adverse effect on our business.

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***Consolidation in the industry, such as AT&T-BellSouth-Cingular, Verizon-MCI and SBC-AT&T, reduces the need for intercarrier transit service and may limit our growth opportunities.***

Consolidation in the industry reduces the need for intercarrier transit services by reducing the number of carriers. As carriers merge, (i) the risks to our business of direct connections increases, see “—The market for our services is competitive and increased adoption of IP switching technologies could increase the competition we face from direct connections” below, (ii) traffic that was carrier-to-carrier becomes intra-carrier traffic not normally addressable by us and (iii) in the case of consolidations involving an ILEC, such as AT&T or Verizon Communications Inc., or Verizon, previous transit traffic between competitive carriers and the carrier acquired by the ILEC now potentially becomes ILEC reciprocal compensation traffic and not transit traffic, and thus potentially not addressable by us. We have experienced growth notwithstanding this consolidation, but our ability to grow in the future could be adversely affected by greater consolidation.

Additionally, in connection with the merger of BellSouth Corp., or BellSouth, and AT&T, AT&T agreed not to seek an increase in its current transit rates for existing transit customers for 42 months in the AT&T and BellSouth LEC service territories. While having no direct regulatory impact on us, this rate freeze potentially limits our ability to enter certain new markets in states where the current transit rates charged by AT&T are so low that our entry would not be economically attractive. Further consolidation in the industry could lead to similar agreements which would limit our ability to grow revenues and may materially affect our results of operations.

***Our top five customers represent in the aggregate a substantial portion of our revenue.***

Our top five customers in the aggregate represented approximately 61% of our expected total revenues in 2006 and our largest customer accounted for approximately one-quarter of our expected total revenues in 2006. These customers could, at any time, solicit or receive proposals from other providers to provide services that are the same as or similar to ours. In addition, our contracts with these customers are non-exclusive, there are no volume or exclusivity commitments by customers under these contracts and any customer is able to discontinue the use of our services at any time.

We may lose business with any of these customers if we fail to meet our customers' expectations, including for performance and other reasons, or if another provider offers to provide the same or similar services at a lower cost. In addition, competitive forces resulting from the possible entrance of a competitive provider could create significant pricing pressure, which could then cause us to reduce the selling price of our services in a manner that could have a material adverse effect on our business, prospects, financial condition and results of operations.

***The market for our services is competitive and increased adoption of IP switching technologies could increase the competition we face from direct connections.***

The most natural form of competition we face is direct connection between our customers. When there is a significant amount of traffic between two switches, there is an economic incentive to directly connect and remove intermediate switching. As our customers grow, the amount of traffic exchanged between them grows, thus leading to the increased risk that they will direct-connect switch paths that exchange significant traffic and remove that traffic from our tandems. The risk of direct connections is increased as more carriers move to an IP-based interface, because direct connecting between two Internet Protocol, or IP, based carriers is less complex than establishing multiple direct connections between carriers' switch pairs, thus enabling more direct connections. In addition, consolidation among telecommunications carriers can stimulate the risk of direct connections by increasing both the incentive and feasibility of executing direct connections. For example, we have noticed that certain competitive carriers established direct connections following completion of a business combination.

In addition to direct connections, our services most frequently compete against the legacy ILEC services. As such, we face competition from large, well-funded ILECs that also provide transit services and for whom transit services are a relatively small percentage of total revenues. Additionally, other companies may be focusing resources on developing and marketing services that will compete with us.